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SUBJECT: BELLWETHER PROJECT: ANDHRA PRADESH: ECONOMY BOOMING BUT
TERRORISM CONCERNS LEAD TO POLITICAL UNCERTAINTY

REFS: A) CHENNAI 541 B) CHENNAI 500 C) CHENNAI 363
D) 04 CHENNAI 487

¶1. (SBU) SUMMARY: The economy of the southern Indian state of Andhra Pradesh continues to boom. But despite strong economic growth led by the IT and pharmaceutical industries centered in the state's capital Hyderabad, the agricultural sector continues to lag and unemployment remains high. The ruling Congress party, which came to power on a populist wave, has deftly catered to the discontented rural masses. The opposition TDP, led by former Chief Minister Chandrababu Naidu, is floundering. Recent terror attacks and charges of rampant corruption in the Congress government may revive the TDP's hopes, but with the elections in 2009 it is too soon to tell. END SUMMARY.

¶2. (U) This is another in a series of cables in the bellwether project launched by Mission India's POL and ECON sections in September 2006 to take the economic and political temperature in states over the next year. Previous reports covered Tamil Nadu, Punjab, West Bengal, Gujarat, Uttar Pradesh, and Bihar. Andhra Pradesh's capital city Hyderabad rivals nearby Bangalore as an IT hub and is the future home of a U.S. consulate.

ANDHRA PRADESH'S ECONOMIC GOOD TIMES KEEP ROLLING

¶3. (SBU) Signs of Andhra Pradesh's economic boom abound in Hyderabad. High-end retailers and restaurants dot the city's constantly expanding upscale neighborhoods. Driving through Hyderabad's technology corridor is a veritable tour of the who's who of the world's information technology companies. The sense of opportunity is palpable, much like in Bangalore, a city with which Hyderabad sees itself competing directly. State government Industries Secretary Sam Bob proudly told post that Andhra Pradesh has moved past Karnataka (the state where Bangalore is located) into second place for foreign direct investment (FDI) among Indian states.

¶4. (SBU) According to the Center for Economics and Social Studies, the state has averaged 7.8 percent annual growth from 2003 through 2007, largely driven by the IT and pharmaceutical sectors. Government and private sector interlocutors uniformly expressed confidence that Andhra Pradesh could continue this run of strong growth. The effects are evident in the state's residential real estate market. A recent newspaper survey showed that residential real estate prices in Hyderabad's exclusive Banjara Hills neighborhood are the most expensive in all of India, eight times more costly than in the next most expensive city - Mumbai.

¶5. (SBU) The effects of the boom have reached into Hyderabad's predominately Muslim, economically disenfranchised old city. Assaduddin Owaisi, the sole member of parliament from the Majlis-e-Ittehadul Muslimeen (MIM) party, said many of the young people from his district in the old city have found work in the IT industry. Owaisi said when he was a young man he would frequently

go to the upscale Taj hotel with friends and they would be the only Muslims present. Sitting in the atrium of the same hotel, Owaisi pointed with great pride to several groups of Muslims having lunch, including a large family that had booked the hotel's most upscale restaurant for a private party. "It was never like this when I was young," Owaisi said. In the lobby of the hotel, visiting political/economic officer met two young Muslims from the old city who were there for an IT conference. Both agreed that new opportunities exist for young Muslims, but they said many of their contemporaries lack the skills to take advantage of them.

COMPETITION KEEPS SOUTHERN STATES ON THEIR TOES

16. (SBU) Industries Secretary Bob told us that competition for business with neighboring Karnataka and Tamil Nadu is "tough." Bob said potential investors regularly "shop" among all three states for the best package of investment incentives. (NOTE: We frequently see potential investors making a circuit of Bangalore (Karnataka's capital), Hyderabad, Chennai (Tamil Nadu's capital), and Pune (in Maharashtra) in advance of making their final decision to invest. END NOTE.) He said companies get an offer letter from one of the states, and then use that offer as leverage to secure further concessions from one of the other states.

17. (SBU) The competition between states is cutthroat. Bob recounted a recent telephone call he made to his counterpart in Tamil Nadu. Bob had asked the Tamil Nadu Industries Secretary for information on the package of incentives offered to Nokia in 2005 to get that company to set up in Tamil Nadu. Bob said his Tamil Nadu counterpart, a fellow officer in the Indian Administrative Service, outright refused to share the information with him. Despite his frustration at the intensity, Bob acknowledged that the competition forces the states to continue improving their business environment and policies. The chairman of the Andhra Pradesh's chapter of the

American Chamber of Commerce agreed that competition between Andhra Pradesh, Tamil Nadu, and Karnataka benefits the states and businesses locating there.

BUT LAGGING AGRICULTURE SECTOR AND LOW EMPLOYMENT GROWTH CAUSE CONCERN

18. (SBU) Strong overall growth does not mean Andhra Pradesh's economy is problem-free. Economist S.M. Dev of the Center for Economic and Social Studies said growth rates for the agricultural sector have lagged, averaging 2.7% from 1993 to 2006. Dev told us that in contrast to states like Tamil Nadu that have achieved "structural transformations" by transitioning the majority of their workforces to non-agricultural labor, more than half of Andhra Pradesh's workforce - 58% - is still employed in agriculture. He added that high growth has not led to greater employment. With employment increasing by an average of only 1.8% year, unemployment increased by 8.2% for the period from 1999 to 2006. High unemployment has led to higher poverty rates in Andhra Pradesh when compared to the rest of south India, as well as lower performance on social indicators such as literacy and infant mortality.

19. (SBU) Dev said he "supports the Washington consensus and economic liberalization" but emphasized that adjustments are necessary to steer Andhra Pradesh towards more inclusive growth. Among a number of policy prescriptions, he said the state must improve agricultural growth rates and create manufacturing jobs. Dev said Andhra Pradesh could not afford to skip past a manufacturing economy directly to a services-based economy because it has to find jobs for 40 million employable, primarily rural youth. Industries Secretary Bob said much the same, "to date Andhra Pradesh has focused on the services sector, but we are now shifting focus to manufacturing."

TERRORISM CASTS SHADOW OVER ANDHRA PRADESH; STATE'S RESPONSE RAISES HUMAN RIGHTS CONCERNS

10. (SBU) On the evening of August 25, bombs exploded within minutes at two separate locations in Hyderabad, the capital of Andhra Pradesh, killing 42 and injuring more than 60 people (ref A). The August 25 bombings came just months after a bomb exploded in

Hyderabad's biggest mosque, Mecca Masjid, on May 18 (ref C) killing nine and injuring 58. In both cases, media reports and statements by government officials blamed terrorist groups based in Pakistan and Bangladesh (ref A) for the attacks, but no conclusive evidence of foreign sponsorship has yet come to light.

¶11. (SBU) In conversations in the days before the August 25 bombings, observers from across the spectrum, including a high-ranking police officer, a human rights lawyer, and two journalists, told post that Andhra Pradesh has a good handle on Maoist (Naxalite) terrorism but is struggling to get a grip on Islamic terrorism. Ref A discusses the August 25 bombings and Islamic terrorist groups in Andhra Pradesh.

¶12. (SBU) K. Balagopal, a human rights lawyer who represents accused Maoists and is sympathetic to their goals, acknowledged that the state's special anti-Maoist force (the celebrated "Greyhounds") has been effective at suppressing Maoist violence. Describing the state's efforts as "a military approach," Balagopal told us that the heart of the state's efforts is an effective intelligence collection system, including strong technical capabilities and a substantial number of paid informants. Balagopal, who has been the target of police investigations himself, said on a number of occasions police officers have known things about him that demonstrated their sophisticated intelligence capabilities. Balagopal said good intelligence coupled with the Greyhounds' ability to "find and kill" suspected terrorists has kept the Maoists in check.

¶13. (SBU) While acknowledging the effectiveness of the government's efforts to combat the Maoists, Balagopal described the cost in terms of human rights. He said extrajudicial killings are standard operating procedure for the Andhra Pradesh police when confronting Maoists. The term "encounter killings" was invented in Andhra Pradesh. It describes the shooting of a suspected Maoist where police later move the victim's body and plant evidence to create the appearance that they killed the Maoist in self-defense or while the victim was attempting to flee. The Andhra Pradesh police used the tactic to such great effect that the practice has migrated to police departments throughout India and the term "encounter killing" has entered the national lexicon. Balagopal added that one aspect of the "encounter killings" has improved: in the past the police frequently killed innocent people but now, with improved intelligence methods, he said they only kill Maoists who are engaged in violence. Balagopal also said that custodial torture by police is "the rule in Andhra Pradesh."

¶14. (SBU) All agreed that development is the long-term solution to the Maoist threat. A high-ranking police official said the state is

working hard to bring development to rural areas because exposing rural youth to its benefits will inoculate them from recruitment by Maoists. He mentioned that the state is providing satellite television connections to rural areas: "if a youth sees [former Miss World and actress] Aishwarya Rai dance on television, there is no way he'll join a Maoist camp," said the police official. Outside observers feel the government's development initiatives are too cosmetic. Balagopal said poverty in the areas where the Maoists recruit has actually increased. A media contact who reports extensively in those areas agreed that the government's development program has fallen short.

CONGRESS GOVERNMENT KEEPS RURAL FOCUS

¶15. (SBU) Chief Minister YSR Reddy led his Congress Party to power in a stunning upset victory in the 2004 elections on the strength of a populist campaign that highlighted rural issues, including a promise of free electricity for farmers (ref D). He has since maintained the focus of his government on programs to benefit the state's rural poor. Prabhakar Reddy, Special Secretary to the Chief Minister, spent the better part of our meeting highlighting the government's irrigation and housing programs. He also said the Chief Minister's promise of free power is open-ended. In contrast, when asked whether the Chief Minister's July 2007 trip to Silicon Valley had resulted in any new investments, Reddy was less animated simply saying investment development is a "constant process."

¶16. (SBU) Sridhar Dudilla, Congress's wip in the state's Legislative Assembly, said the Chief Minister is popular because his governments programs address the needs of the rural poor and he farm sector. Dudilla said addressing rural neds is a political imperative because 65% of thestate's population depends on agriculture. For hat reason, the government has dedicated fully oe-third of the state budget to irrigation projects lone. Dudilla, however, emphasized that the govenment was not neglecting industrial development: he said the government wants balanced developmet for Andhra Pradesh, which necessarily includes idustry.

Media observers agreed that Congress is n a strong position because the government has dlivered on its election promise of free power, ad has gone a step further with its aggressive irriation program. On top of it all, they noted, th monsoon rains have been good, making farmers allthe more happy.

NAIDU'S TDP "RUDDERLESS"

¶17. (SBU) One journalistdescribed former Chief Minister Chandrababu Naid and his Telugu Desam Party (TDP) as "rudderless." Devender Goud, a former TDP Home Minister and curent member of the legislative assembly, outline a TDP position that could be described as tryin to "out Congress" the Congress party. Acknowledging that Congress had seized the political high grund with its programs aimed at the agricultural sctor, Goud said "we will do even more for farmer." He said the TDP would continue the Congress overnment's policy of free power for farmers (a poicy the TDP opposed during the 2004 elections). When asked about the government's allocation of 3% of the budget for irrigation projects, Goud sad the TDP would increase spening to 50% of the budget.

¶18. (SBU) Goud conceded that Congress had done a good job on the economy and law and order, two issues that the TDP traditionally dominates. A TDP government would offer much of the same on agriculture, economic development and law and order, he said, with "the only difference being that Congress is more corrupt." Contacts from the media, business, and academic communities agreed that corruption, especially relating to the irrigation and housing programs, is rampant. But they feel that corruption alone will not be sufficient for the TDP to prevail against Congress. One contact said "a certain amount of corruption is expected" by the electorate, especially in projects like the irrigation program. They explained that so long as some benefit reaches the farmers they will accept the corruption.

ALL POLITICS ARE LOCAL: CIV-NUKE NOT A FACTOR

¶19. (SBU) Our contacts uniformly felt the national debate on the U.S.-India civil nuclear agreement will not have a significant impact on the state's politics. Congress whip Dudilla said people simply "don't know what the 123 agreement and the Hyde Act are." These issues "might matter in Delhi but they don't matter to people here," he said. Owaisi of the MIM said much the same, "what matters is people's pocketbooks." (NOTE: Owaisi did say that India's Muslims "hate George Bush" but will support the agreement because Prime Minister Singh has assured the Indian people that the agreement is for the good of India's prosperity and security. END NOTE.) The TDP's Goud said there is a great deal of "confusion"

about the meaning of the deal. A journalist put it simply: "the common man is not interested at all in the 123 deal."

CONSENSUS IS UNCERTAINTY
PREVAILS; TERROR ATTACKS A WILDCARD

¶20. (SBU) COMMENT: According to our media contacts, even with Congress "playing its cards right" and the TDP "rudderless," it is too early to tell what will happen in the 2009 elections. They said the situation will be fluid until at least 2008. Uncertainty abounds with the TDP flirting with the possibility of joining forces with its former enemies in the Left parties, Congress ally MIM under increasing pressure from Left parties' efforts to woo Muslims in the old city, and the increasing drumbeat of corruption charges against the Congress party.

¶21. (SBU) COMMENT CONTINUED: The August 25 bombings only increased the uncertainty, providing another avenue of attack for the TDP against Congress. Naidu and the TDP quickly took the offensive, calling for the Chief Minister's resignation on the grounds that the Mecca Masjid bombing in May and the August bombings demonstrate Congress's inability to keep the state's citizens safe. They argue that Congress political leaders' appeasement of the MIM and its Muslim base has interfered with intelligence and law enforcement efforts to combat terrorism. Media reports have speculated that, unlike the Mecca Masjid bombing, the August 25 bombings could have an impact on Congress's electoral fortunes because August bombings killed Hindus as well as Muslims. Whether a focus on terrorism and corruption can combine to overcome Congress's targeted appeal to Andhra Pradesh's rural masses remains to be seen. END COMMENT.

¶22. This message was coordinated with Embassy New Delhi.

HOPPER